



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
Attn: Mandatory Review, MC 4920 DAL
1100 Commerce St.
Dallas, TX 75242

501.10-00

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Date: June 9, 2010

Release Number: 201039038

Release Date: 10/1/10

LEGEND

ORG = Organization name

XX = Date Address = address

Employer Identification Number:

Person to Contact/ID Number:

Contact Numbers:

Voice:

Fax:

ORG

ADDRESS

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

This is a final adverse determination letter with regard to your status under section 501(c)(10) of the Internal Revenue Code.

You are a subordinate organization included in group exemption number 9470. The parent organization was granted tax exempt status as an organization described in section 501(c)(10) of the Code in May 19XX.

The primary activity of ORG (ORG) is the operation a commercial bar open to the general public. The current officer and owner, , created ORG with the intent to generate profits. All assets and net earnings of ORG belong to . Members of ORG do not have a common fraternal bond.

ORG is not a domestic fraternal society operating under the lodge system, the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes.

The organization does not qualify for exemption under section 501(c)(10) of the Internal Revenue Code. Consequently, the organization's exempt status is revoked effective April 1, 20XX. You have agreed to the revocation of your exempt status by signing Form 6018-A.

You are required to file Forms 1120 with the appropriate Service Center for the tax periods beginning on and after April 1, 20XX.

You have the right to contact the Office of the Taxpayer Advocate. Taxpayer

Advocate assistance is not a substitute for established IRS procedures, such as the formal Appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at: (314) 612-4610 (not toll-free).

If you have any questions, please contact the person whose name and telephone number are shown at the beginning of this letter.

Sincerely,

Nanette M. Downing
Director, EO Examinations



DEPARTMENT OF THE TREASURY

INTERNAL REVENUE SERVICE

TE/GE EO Examinations

MS:4957:DAL

1100 Commerce Street

Dallas, TX 75242

TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION

Taxpayer Identification Number

ORG
ADDRESS

Form:

Tax Year(s) Ended:

Person to Contact/ID Number:

Contact Numbers:

Telephone:

Fax:

CERTIFIED MAIL – RETURN RECEIPT REQUESTED

Dear

We have enclosed a copy of our report of examination explaining why we believe an adjustment of your organization's exempt status is necessary.

If you accept our findings, please sign and return the enclosed Form 6018-A, *Consent to Proposed Action*. We will then send you a final letter revoking your exempt status.

If we do not hear from you within 30 days from the date of this letter, we will process your case on the basis of the recommendations shown in the report of examination and this letter will become final. In the event of revocation, you will be required to file Federal income tax returns for the tax period(s) shown above. If you have not yet filed these returns, please file them with the examiner as soon as possible, unless a report of income tax liability was issued to you with other instructions. File returns for later tax years with the appropriate service center indicated in the instructions for those returns.

If you do not agree with our position, you may appeal your case. The enclosed Publication 3498, *The Examination Process*, explains how to appeal an Internal Revenue Service (IRS) decision. Publication 3498 also includes information on your rights as a taxpayer and the IRS collection process. Please note that Fast Tract Mediation Services referred to in Publication 3498, do not apply to Exempt Organizations.

If you request a conference, we will forward your written statement of protest to the Appeals Office and they will contact you. For your convenience, an envelope is enclosed.

If you and Appeals do not agree on some or all of the issues after your Appeals conference, or if you do not request an Appeals conference, you may file suit in the United States Tax Court, the United States Court of Federal Claims, or the United States District Court, after satisfying procedural and jurisdictional requirements as described in Publication 3498.

You may also request that we refer this matter for technical advice as explained in Publication 892, *Exempt Organizations Appeal Procedures for Unagreed Issues*. If a determination letter is issued to you based on technical advice, no further administrative appeal is available to you within the IRS on the issue that was the subject of the technical advice.

You have the right to contact the office of the Taxpayer Advocate. Taxpayer Advocate assistance is not a substitute for established IRS procedures, such as the formal appeals process. The Taxpayer Advocate cannot reverse a legally correct tax determination, or extend the time fixed by law that you have to file a petition in a United States court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling. You may call toll-free, 1-877-777-4778, and ask for Taxpayer Advocate Assistance. If you prefer, you may contact your local Taxpayer Advocate at:

If you have any questions, please call the contact person at the telephone number shown in the heading of this letter. If you write, please provide a telephone number and the most convenient time to call if we need to contact you.

Thank you for your cooperation.

Sincerely,

Director, EO Examinations

Enclosures:

Publication 892

Publication 3498

Form 6018-A Report of Examination

Envelope

Form 886A	Department of the Treasury - Internal Revenue Service Explanation of Items	Schedule No. or Exhibit
Name of Taxpayer ORG EIN: #		Year/Period Ended March 31, 20XX

LEGEND

ORG = Organization name XX = Date State = state President = president CO= CO CO-1 = CO-1

ISSUE

Whether ORG is operated exclusively for exempt purposes described within Internal Revenue Code section 501(c)(10).

FACTS

ORG (hereinafter "ORG") whose Employer Identification Number is #, was incorporated in the State of State. ORG was recognized as an organization exempt from federal income tax as described in IRC Section 501(c)(10) under the group ruling number . ORG operated a bar named CO.

In Chapter 311, Section 311.090 of the State Revised Statutes, Liquor Control Law, "in order for a licensee to sell intoxicating liquor outside city limits, a licensee must meet certain provisions such as having obtained an exemption from the payment of federal income taxes as provided in IRC sections 501(c)(3), 501(c)(4), 501(c)(5), 501(c)(7), 501(c)(8), 501(c)(10), 501(c)(19), or 501(d) of the United States Internal Revenue Code of 1954, as amended in any incorporated city having a population of less than 19,500 inhabitants as determined by the last decennial census under the provisions and methods set out in this chapter." Also, in Chapter 311, Section 311.097 of the State Revised Statutes, Liquor Control Law states "that an organization can obtain a license to sell liquor by the drink if at least 50% of the gross income of which is derived from the sale of prepared meals or food consumed on such premises or which has an annual gross income of at least \$ from the sale of prepared meals or food consumed on such premises.

Before forming ORG, the officer, President had operated the bar that was able to sell beer only. To attract more customers, President would like to obtain liquor license for her bar. The officer was sure that her bar was unable to meet food sale requirements, so the only option she had to obtain the liquor license is to become a tax exempt organization. She knew about CO-1 from the bars around that were CO-1 subordinates. The officer got the CO-1 National Headquarters' contact information from the bar where her son worked. The officer called CO-1 National Headquarters to ask about the information on how to apply, requirements to become a CO-1 subordinate, and how to maintain the status of CO-1 subordinate.

The parent organization's Constitution and Bylaws state that CO-1 purpose is "to promote fellowship among all living beings, respectfully; to encourage the elimination of prejudice and help unify divergent groups in the overall interest of American democracy; to orientate our youth with full knowledge of responsibilities as well as privileges of

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citizenship through the wisdom of our seniors; to assist the underprivileged and well deserving by maintenance of sponsoring educational opportunities and by providing monetary grants and awards toward their wellbeing overall; to fully support the effort of "Drug Free America;" to encourage compassion for every fellow man, woman and child in distress and/ or deserving; to provide social clubs for members and guests for the purpose of fellowship and entertainment of its members; to create and initiate new programs to assist the homeless, battered and abandoned children, the mentally retarded, and the needy and well deserving for the purpose of their well-being."

Requirements to become a CO-1's subordinate are as follows:

1. Start the chapter with 25 members at annual dues of \$ each. By the seventh year of incorporation the subordinate is required to have 32 members. The dues will be split 50/50 between the parent organization and subordinate for each membership sold after 32.
2. Donate \$ to other approved non-profit entities. All donations must be verified by providing the CO-1 National Headquarters copies of canceled checks submitted for donations. If donations are given to needy individuals, subordinate must submit the name of the individual, social security number, date of birth, address, the reason for the donation, and the amount of the donation.
3. Conduct monthly meeting

After President contacted the CO-1 Headquarters to ask for steps and the information to become a CO-1 subordinate, she received the package including the following material from the CO-1 Headquarters:

- A. Constitution and Bylaws of CO-1
- B. Membership requirements
- C. Instructions on how to prepare Articles of Incorporation
- D. State Liquor Control Checklist prepared by CO-1 National Headquarters to help the organization prepare all necessary Forms filed with Division of Liquor Control to obtain liquor license. The following information listed on the checklist:
 1. *Certificate of Incorporation*
 2. *Articles of Incorporation (copy) after filed with the State Secretary of States Office*
 3. *Property/Dwelling Lease Agreement*
 4. *Bill of Sales of Inventory & Fixtures*
 5. *Managing Officers Appointment Form*
 6. *Subordinate Group Authorized Form*
 7. *2 page Tax Exemption Letter (receivable on payment of charter fees and membership dues).*

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Article III, part 4 of the Articles of Incorporation states that, each CO-1 post/lodge will be committed to contribute \$ each year to charity(s) of the post/lodge choice. These charities may be within the post's own community. Verification of donations must be submitted to the CO-1 National Headquarters monthly to be placed in each post/lodge file.

The officer did not change anything inside or outside of the bar when the bar was operated under ORG. The old name of the bar, CO, was still used by the organization. The bar was open the general public.

To meet the membership requirement, the officer invited her customers to become members. Members were required to pay membership dues. Members were not required to pay sales taxes for their drinks.

There is a complete lack of regalia or memorabilia specific to the CO-1 either inside or outside the organization. The organization is devoid of any rites or rituals specific to the CO-1 culture when the meetings are held or when new members are recruited. ORG has only one class of membership.

LAW

Internal Revenue Code subsection 501(c)(10) provides an exemption for domestic fraternal societies, orders, or associations, operating under the lodge system, the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes, and which do not provide for the payment of life, sick, accident, or other benefits.

Income Tax Regulation section 1.501(c)(10)-1 provides that an organization will qualify for exemption under section 501(c)(10) if it is a domestic fraternal beneficiary society order, or association, described in section 501(c)(8) and the regulations thereunder except that it does not provide for the payment of life, sick, accident, or other benefits to its members, and devotes its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes.

Internal Revenue Code section 501(c)(8) provides an exemption from taxation for fraternal beneficiary societies, orders, or associations operating under the lodge system or for the exclusive benefit of the members of a fraternity itself operating under the lodge system and providing for the payment of life, sick, accident, or other benefits to the members of such society, order, or association or their dependents.

Rev. Rul. 81-117, 1981-1 C.B. 346 states that an organization that does not conduct any fraternal activities or operate under the lodge system, but does operate exclusively for the

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benefit of members of certain related domestic fraternal societies operating under the lodge system, does not qualify for exemption under section 501(c)(10) of the Code.

Rev. Rul. 73-165, 1973-1 C.B. 224A defines a fraternal beneficiary society, order, or association exempt under section 501(c)(8) as one that, in addition to being operated in furtherance of fraternal purposes, (1) is so operated under the lodge system or for the exclusive benefit of the members of a fraternity that is so operated under the lodge system, and (2) has an established system for the payment to its members or their dependents of life, sick, accident, or other benefits. There is no requirement that either the fraternal features or the insurance features predominate so long as both features are present.

In *National Union v. Marlow* 374 F. 775, 778 (1896) a fraternal beneficial society was defined as one whose members have adopted the same, or a very similar calling, avocation, or profession, or who are working in union to accomplish some worthy object, and who for that reason have banded themselves together as an association or society to aid and assist one another, and to promote the common cause. The term "fraternal" can properly be applied to such an association, for the reason that the pursuit of a common object, calling, or profession usually has a tendency to create a brotherly feeling among those who are thus engaged. The National Union did not fit this definition, because it was an association of individuals who were associated for the purpose of obtaining insurance. The court concluded that: *"In its practical operations, therefore, the defendant company cultivates fraternity and confers benefits in the same manner that every insurance company doing business on the mutual plan cultivates feelings of fraternity, and confers benefits upon its members. Or, in other words, when the defendant is stripped of all disguises, and judged by the standard of what it is engaged in doing, and what it was most likely organized to do, it is simply an insurance company which carries on an extensive business on the assessment plan."*

The court in *Polish Army Veterans Post 147 v. Commissioner*, 24 T.C. 891, reversed on other grounds, 236 F.2d 509 (3rd Cir. 1956) concluded that an organization had not established its exemption as a fraternal beneficiary society because members lacked a common tie: to qualify for the exemption an organization must be fraternal Here only the active members, comprising less than 10 per cent of the total membership of the Post, had a common tie. They, of course had the bond of having formerly served in the Polish Army. But approximately 90 percent of the total membership of the Post was social members who were not ex-members of the Polish Armed Forces and who ... had nothing in common with the active members or with each other. An organization cannot be classed as fraternal where the only common bond between the majority of the members is their membership in that organization.

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Fraternal Order of Civitans v. Commissioner , 19 T.C. 240 (1952) provided that the requirement of common ties and objectives is not satisfied merely by a recitation of such purposes in the association's constitution or bylaws. It is necessary that the stated purposes be implemented or accomplished by specific acts. The Tax Court denied exemption to an organization whose constitution called for, among other things, the promotion of civic enterprises in the community. It engaged in no civic or charitable activities during the period under review.

The court in Western Funeral Benefit Association v. Hellmich , 2 F.2d 367 (E.D. Mo. 1924), stated that "by the 'lodge system' is generally understood as an organization which holds regular meetings at a designated place, adopts a representative form of government, and performs its work according to ritual."

Philadelphia and Reading Relief Association, 4 B.T.A. 713 (1926), held that where the sole motive in joining an organization is to receive insurance benefits, and there are no lodges, rituals, ceremonies or regalia, then there is no fraternal element present.

Knights of Columbus Building Association of Stamford, Conn., Inc. v. United States, 61 AFTR 2d 88-1212 (DC Conn. 1988), held that an organization that operated a bar and buffet that was utilized by nonmember community organizations was not operating with the exemption provisions and therefore was not exempt under IRC §501(c)(8).

TAXPAYER'S POSITION

ORG consents to the proposed revocation.

GOVERNMENT'S POSITION

ORG is not a domestic fraternal society because the members do not have a common tie or objective. The only common bond between the members is their membership in ORG. Members of ORG do not have a common fraternal bond. The members do not possess a similar calling, avocation, or profession, and are not working in unison to accomplish any worthy objective or common cause. Rituals, ceremonies, and regalia that are evidence of fraternal activities are not found in ORG. ORG has not been neither operating for religious, charitable, scientific, literary, educational and fraternal purposes, nor devoting its net earnings exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes. The current officer, President, created ORG with the intent to generate profits. All assets and net earnings of ORG belong to the owner, President.

ORG is not operating under the lodge system. ORG is a member of the parent organization through the payment of dues and a charter fee. The term "membership dues" implies that each member pays a fee for membership because they place a value on

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their association with the organization and that there are rights, privileges or benefits associated with membership. The organization does not have a set meeting schedule and there are no rituals associated with the meetings. The organization does not have a representative form of government because the members have no voice or voting rights in the business operation of the organization or the net earnings. The officers are not selected or elected by the membership.

During the year under audit, although ORG donated \$/month to some charities, that does not make ORG meet the 501(c)(10) requirements. ORG is operating in a commercial manner which is not an exempt activity described under Internal Revenue Code section 501(c)(10).

CONCLUSION

In the case of ORG, it is held that, where the primary purpose or activity of the organization is the commercial manner in which the bar operates. ORG is not a domestic fraternal society operating under the lodge system, the net earnings of which are devoted exclusively to religious, charitable, scientific, literary, educational, and fraternal purposes. The organization does not qualify for exemption under section 501(c)(10) of the Internal Revenue Code. Consequently, the organization's exempt status is revoked effective April 1, 20XX.

Forms 1120 should be filed for the tax periods ending on and after March 31, 20XX.